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Some Transaction Cost Effects of Authoritarian Management

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This paper studies the transaction-cost economizing effects of authoritarian management in organizations and systems subject to higher transaction costs originating from various sources. We analyze the nature, mechanisms and transaction-cost aspects of the authoritarian management style. We argue that the higher the transaction costs of internal organization, the more autocratic the manager is likely to be. We study the features of authoritarian managers in general but more specifically in the context of high transaction-cost systems such as East European societies with significant transactional or organizational opportunism as well as other sources of market failure.

Keywords: authoritarian management, transaction costs, opportunism, multidivisional structure, information transfer

JEL classification: D23, L23, M12, P21, P31

1. Introduction

Modern organizational theory views authoritarian management as a conservative and outdated approach to running an organization. Many examples are given of innovative, transformational leaders in modern organizations who lead their employees in a democratic, creative and inspiring way. Innovative, high-tech companies such as Microsoft, Google, Facebook or Yahoo serve as examples of modern management, delegating power to employees who are not closely monitored by their direct managers but have full freedom to decide when and how to perform their job responsibilities. Absenteeism is allowed and full trust is delegated to employees as long as they get the job done.

At the same time conservative and autocratic business leaders are condemned for being too outdated in their practices and uninspiring for their employees. This paper argues that the authoritarian management style, although much less applied than in the past, serves to reduce the transaction costs of internal operation and is still in use in some organizations. These are organizations faced with significant transaction costs of various types and origins, operating in specific market conditions or systems where authoritarian leadership is the only possible way to effectively run the organization. The higher the intrafirm transaction costs of management in running the organization, the more likely it is for the managerial style to be autocratic. By transaction costs we perceive both the costs of market operation and the costs of internal organization and management within the firm, as defined by Coase (1937). These costs of market exchange are considered in comparative terms – if the marketing costs of using the exchange mechanism exceed those of managerial coordination within the firm, the manager undertakes more and more activities expanding thus the size of the firm. Coase (1937) does not specifically address different managerial styles but the presumption is that the manager directs in an administrative, bureaucratic way giving commands and directions and allocating resources at his own discretion¹. This centralized, intentional coordination resembles command-and-control decision making more than the atomistic, uncoordinated, spontaneous and democratic allocation provided by the market. The manager-entrepreneur does all the planning. According to Coase (1937, 391) the costs of negotiation are avoided in the administrative mode and a series of contracts are substituted by a single, employment contract. Thus tedious, protracted negotiations are avoided within the firm with the help of the administrative approach. Administrative allocation and transaction costs seem invariably related.

Williamson (1985, 47) adds to the study of *ex ante* and *ex post* transaction costs the concept of opportunism. Except the costs of search, information, bargaining and insurance against market risks prior to concluding a deal, firms undertake legal actions against opportunistic contractual partners when those partners try to obtain their quasi-rents or take advantage of them through the holdup problem with specific assets or general-purpose assets which in the process of contracting turn into specific assets². He defines opportunism as the strong form of selfishness. It refers to lying, misleading, hiding or distorting information, obfuscating, stealing or cheating in market dealings. Outside of the firm opportunism can take the form of asymmetric information, adverse selection or misrepresented quality all of which may bring the market to a complete market failure in a low-end equilibrium trap. But within the firm

¹ Coase (1937, 387), for instance, gives the example of the manager directing a worker from department Y to department X based not on the price of the worker but his own judgment.

² Williamson (1985, 61) calls this moment of locking in a partner when even general-purpose assets turn into specific ones “the fundamental transformation” which creates incentives even for non-opportunistic firms to take advantage of their commercial partners.

opportunism takes more blatant forms such as shirking, adverse selection in hiring or performance, cheating and even stealing on the job. The managerial transaction costs of internal organization then include the costs of monitoring the actions of workers and employees with organizations, spheres and societies more susceptible to opportunism on the job being open to higher transaction costs. In such special circumstances of extreme intrafirm opportunism authoritarian management turns into a transaction-cost minimizing mechanism more than the democratic style of leadership which can hardly handle highly opportunistic workers. It is likely that greater centralism exists in organizations subject to higher internal transaction costs.

The authoritarian approach derives from the views of Taylor(1911) as to how to motivate workers. Taylor was the first to suggest that methods from engineering and science be combined with the organization and coordination of human labor. This branch in management theory widely known as scientific management (or Taylorism) aims to increase economic efficiency and labor productivity. A high level of managerial control over employee work practices is necessary. Taylor (1911, 5) describes shirking with the term “soldiering” when a “man deliberately plans to do as little as he safely can to turn out far less work than he is well able to do.”³ He observed that when workers are paid the same or are forced to perform repetitive tasks, they tend to work at the rate of the slowest one among them. This slow rate reduces the overall prosperity of society, profits and worker wages. To motivate workers managers should pay them based on their productivity, usually on a piece rate. Time and motion studies combined with rational analysis would provide the best method for performing particular tasks⁴. In Taylor’s theory worker compensation is critically linked to output and performance, in other words, authoritarian management paired with engineering techniques or optimization tools can only work in the presence of motivating factors such as pay.

Organizational theorists such as Barnard (1938), Simon (1947) and Chandler (1962) also study managerial styles with relevance to the type of the organization. Barnard (1938) formulates the functions of the executive and introduces the acceptance theory of authority where subordinates accept the seniority and hierarchy of management within an organization. Simon (1947) distinguishes between the rational, optimizing man and the administrative man who has limited knowledge of the environment and has to make decisions accordingly. As an economic and organizational historian Chandler (1962) traces the roots of the modern corporation studying its evolution from a simple linear form to the

³ Taylor (1911) with his scientific management is perhaps the first in management science to discuss shirking on the job as a problem to achieving high productivity levels. Consequently scientific management has not been put in a transaction-cost context.

⁴ Some essential fields are said to have evolved from scientific management, particularly, operations management, operations research, industrial engineering, logistics, etc.

contemporary diversified structure. These scholars do not put organizational theory in a transaction-cost perspective. We try to make up for that by merging the tools of standard economic theory and new institutional analysis with management science. Our contribution is the application of an integrated approach, that of new institutional economics and more specifically transaction cost analysis jointly with organizational theory. Our study also extends new institutional economics a step further – whereas new institutionalists do not study the effects of intrafirm transaction costs on management, we attempt to relate the level and types of these costs to managerial style and organizational form.

2. Types of leadership and managerial styles

Based on the distribution of power within firms three major types of leadership could be discussed. In most organizations the **authoritarian** (or autocratic) managerial style is considered outdated and inefficient in inspiring workers to deliver the maximum of their marginal product. Management scientists and firm theoreticians reject this type of management as being too conservative in that managers control workers too closely and make all important decisions on their own. Managers do not trust workers and give commands which should be followed without any discussion, questioning or negotiation. Thus the authoritarian management style relies chiefly on commands and obedience in what is seen as one-way communication. Often the limitations of this approach are stressed without sufficiently accounting for the fact that the authoritarian management style is still widely used in firms. The rationale for the wide application of this type of management under different systems and in different types of organizations has not been analyzed sufficiently.

The **democratic** leadership style, contrary to the authoritarian one, resembles a two-way communication putting emphasis on the employees. They are not directly given commands but rather participate in the decision making process equally with management. Thus management delegates authority to workers and puts trust in them. This is predicated on the fact that employees are considered people with expertise who have sufficient knowledge about the production process and can engage equally in the governance of the organization. Thus their valuable knowledge, suggestions and ideas are solicited in discussion groups on a democratic basis. The need to supervise, monitor and control such knowledgeable subordinates in intellectual institutions may be insignificant due to lack of opportunism on their part.

The **paternalistic** management style borders the democratic one in that managers behave as father figures when it comes to the protection, encouragement and development of the personnel. Paternalistic managers prioritize the social needs of their workers and respect their opinions. Worker happiness and satisfaction are essential to managers. The paternalistic manager is usually a senior person with authority, organizational knowledge and experience. He consults employees, listens to their claims, complaints,

desires and preferences. He solicits their feedback on essential decisions taken within the firm. While the manager tries to create a positive and pleasant environment for subordinates he does not delegate power and authority but makes decisions on his own. These decisions are believed to be in the interest of the organization and the staff but the lack of empowerment is the reason why paternalistic management is seen as somewhat of an autocratic approach. The paternalistic approach, while close to the authoritarian style of management, creates stronger motivation for workers to contribute to the enterprise mission and output.

Based on the attitude to innovation, time span and change, two essential managerial styles are transactional and transformational management. In view of the time horizon these two styles resemble tactic and strategic management, respectively. **Transactional** leadership pursues tactic or operational, day-to-day goals by maintaining the normal flow of operations. In this sense, transactional leadership keeps the institution going. Transactional leaders busy themselves with day-to-day operations and pursue short-term or medium-term goals. They are unconcerned with the long-term vision, mission or strategy of the firm. In achieving these daily goals they use a variety of instruments, ranging from disciplinary power and penalties to incentives and rewards for workers.

Opposite to transactional leaders, **transformational** leaders look ahead strategically guiding the organization to market or industry leadership; their time span is much longer setting the long-term vision and mission of the organization. Therefore, transformational leaders are strategic managers who try to insure the long-term success of their unit, department or organization. Both types of management have transaction-cost aspects in the multidivisional structure, where strategic decisions are separated from operational, day-to-day decisions in order to save on those costs. This distinguishes the multidivisional, diversified form from the linear, unitary or hierarchical firm form where all decisions are taken at the level of top management but a strategic unit is absent. Transformational leaders are said to focus on team-building, motivation and collaboration of employees so that to carry out change effectively. At the same time, personal and professional growth for all employees is aimed at. From the point of view of innovation, transformational leadership is clearly oriented to change and is driven by innovation. Much of the time the need for change is provoked by a dynamic, unstable and competitive environment where the long-term survival of the organization is at stake.

3. The characteristics of authoritarian leadership

Authoritarian leaders rarely accept advice or solicit input from their subordinates. They exert full control over all decisions in the organization and dictate all the work methods and processes in it. An extreme form of authoritarian leadership is the command-and-control approach applied in highly centralized

organizations where army-like discipline, direct commands and strict punishment serve to curb workers in achieving the goals of the organization.⁵ Authoritarian management is still widely spread although many organizational theorists expect otherwise. Seddon (2005) maintains that command-and-control is still the dominant style of leadership in many organizations. He attributes this to the lack of knowledge or competences on the part of managers who do not have a better way of managing people in the organization. Gill (2010), on the other hand, argues that it is not so much the lack of knowledge but the fear of losing control that forces managers to resort to command-and-control. He stresses that “switching to a people-centered approach means relinquishing control to others and trusting that employees will not abuse that responsibility.” This is not easy for most leaders to do and only very confident and comfortable managers can delegate control and trust to employees.⁶ It, therefore, seems that organizations and managers in stressful situations are most likely to resort to strict control so that to minimize risks and stress.

A primary characteristic of authoritarian leadership is that group members are not trusted with decisions or important tasks. The issue of trust is key to the problem of authoritarian management in organizations. Trust is generally a problem in business dealings but in firms or other organizations the lack of trust is a primary source of organizational transaction costs.⁷ Some minimum degree of trust is necessary not only for market exchange but also in order for organizations to operate smoothly and achieve their mission. Organizational trust reduces the costs associated with monitoring, information transfer, internal negotiations and intrafirm transactions. Employees should be very well prepared to accept power from the manager but should also be sufficiently conscientious and morally loyal to the manager or the institution in order to perform well. Thus empowered workers should be 1) technically equipped to perform in the best interest of the organization and 2) loyal, trustworthy and moral individuals who can perform the tasks conscientiously and in good faith.

Command-and-control leaders exert absolute power and control; their personality is perceived by subordinates as knowledgeable, authoritative and senior. They are figures of authority and high status. The top-down approach fits well with bureaucratic organizations in which workers accept the power and authority of senior management. The strict hierarchy draws a clear separation line between the two groups. Since top managers are people with expertise and experience, they are not seen by workers as

⁵ In many ways command-and-control and authoritarian management can be seen as synonyms. We treat these two approaches as analogous or identical in the paper.

⁶ Gill (2010) writes further: “... in times of stress, it is the human tendency to narrow our field of vision and revert to controlling behaviors that feel safe and less risky to us, whether they are or not.”

⁷ Arrow (1969, 501) emphasizes that in the absence of trust it would become very costly to arrange for alternative sanctions and guarantees, and many opportunities for mutually beneficial cooperation would have to be forgone.

unintelligent or incompetent. On the contrary, because workers see them as highly knowledgeable in a complex production process or environment, workers accept the authority of authoritarian leaders without questioning. Thus workers are aware of the complexity of the production process, situation or firm and realize the threats posed on the organization by the external environment. Workers thus surrender their autonomy, independence, creativity and freedom to such dictatorial managers for the sake of efficiency and the survival of the organization. The acceptance theory of authority (Barnard 1938) applies to such institutions where workers accept the right of the manager as a highest authority to give orders and expect compliance. Workers believe that the manager can legitimately give commands and that he would rightfully expect those commands to be fulfilled or obeyed. According to Barnard (1938) when there is acceptance of authority:

- 1) workers will be rewarded for compliance;
- 2) there will be discipline for non-compliance;
- 3) workers respect the manager for his experience.

Baldoni (2010) adds that except a position of authority the leader must earn the trust and respect of followers. He formulates “earned authority” as the authority of the leader who leads by example and has to prove himself to his subordinates. Baldoni (2010) distinguishes between conferred managerial positions and real leadership and in this his view of “earned authority” resembles the concept of formal and informal leadership in management theory. True authority thus is associated with the real power and influence over others, not with empowerment within the firm.⁸

4. The transaction cost aspects of authoritarian management

That authoritarian management has transaction cost saving effects is not immediately visible. Many western business and other organizations operate as democratic entities with large delegation of power to subordinates. Such institutions may exist in a dynamic or risky environment but the transaction costs of organizing their internal operations are usually low. A high tech firm or a university would be examples of low-transaction cost institutions, whereas a production firm, a furniture plant or a textile factory would represent high-transaction cost organizations where the transaction costs of monitoring and control are sizable. High-transaction cost organizations welcome authoritarian leadership more than low-transaction

⁸Baldoni (2010) concludes: “Leadership presence is “earned authority”... Earned means you have led by example. Authority means you have the power to lead others. While organizations confer management roles, it is up to the leader to prove himself or herself by getting others to follow his or her lead. A leader must earn the right to lead others. Title is conferred; leadership is earned... While leaders project power through presence, it is followers who authorize it with their approval.”

cost organizations. Stronger control is exerted in those while managers are blamed for being autocratic and dictatorial. In sectors of the economy or spheres of life where market failures and nonperformance are more prevalent this is an efficient way of running an enterprise. In the extreme case, societies more prone to transactional opportunism, noncompliance, shirking or cheating, where cheating can occur in any form authoritarian management and strict control are the only way to prevent the high transaction costs of internal organization. The sources of such transactional opportunism and misconduct in such societies may be diverse – lack of market culture, lack of tradition in the operation of the market, absence of market customs and rules, the traits of historical development based on agriculture, rather than industry, lack of industrial relations or their development, absence of an industrial revolution, extreme selfishness on the part of most members of society, lack of trust in markets and their evolution, lack of trust in other market participants and contractual partners, etc. Managerial transaction costs within firms include 1) the transaction costs of negotiation, discussion or bargaining within the firm where direct commands save on those costs, 2) the costs of detecting, monitoring, preventing and penalizing opportunism on the job, 3) the costs of consolidating, processing, transmitting and disseminating information and 4) the costs of quality control.

Authoritarian management can significantly lower transaction costs within the firm when the majority of workers are uneducated, unqualified or uninformed. With the low level of competence of the personnel workers in effect surrender some autonomy to knowledgeable, experienced managers with the purpose of achieving the organizational goals. Thus the authoritarian management style assumes a high level of competence of top management and necessitates that managers be sharp, creative and talented. This contradicts the common belief that dictatorial managers are always simple-minded people. Workers realize that it is to their benefit to trust the expertise, decision-making power and judgment of a well-prepared manager. Workers in the organization trust the knowledge, skills and sound leadership of the leader/manager. The managerial function thus resembles a credence good in which unknowledgeable workers trust the expertise of the superiors. Contrary to the common perception, there is trust in the leader within authoritarian organizations. Those are not necessarily non-cooperative organizations.

Democratic institutions which delegate power to employees often find themselves faced with a lower level of opportunism. Examples may be high-tech or other innovative companies where the majority of employees are highly qualified, technically knowledgeable and fully aware of the goals of the organization. Such educated individuals realize the essence *andraison d'être* of the organization, perform their obligations duly and need not be monitored strictly. There is little potential for opportunism in democratic organizations. Those are usually firms operating in a competitive environment with a high market dynamics. According to Nye (2008, 68) such unstable and unpredictable environments require an

inspirational and soft power style which is more likely in periods of rapid and discontinuous change⁹. In highly technological sectors with teams of highly skilled employees (for example, engineers, programmers, inventors or innovators) the authoritarian style is inappropriate. In such innovative organizations the democratic style of leadership provides for more autonomy and creativity of subordinates and mimics a market-like environment where market-type decisions are taken within the firm. Low or inexistent opportunism provides for low intrafirm transaction costs. Low shirking with high-skilled labor which generates a high-value, highly specialized, highly technological or sophisticated product and understands the goals of the organization predetermines equity between management and staff. Organizational structure therefore is flat with little centralism or hierarchy. Information flow is greater with more information being solicited from subordinates and more information being provided by managers. Managers hear the opinions of subordinates. Decision making in democratic institutions is slow since debates and arguing give the best solutions to problems. Technical processes and technological products at the same time require debating, analysis and time. Units and individuals have little incentive to hide information.

In some production processes workers are low-skilled or incapable of making decisions by themselves. They have low learning curves or learning processes take longer than expected. Such production processes provide little time for training or requalification and usually require little creativity. When skills are in short supply people need to be guided through a task or tasks with clarity and structure. Low-skilled, less sophisticated workers may be more susceptible to shirking. The potential for intrafirm opportunism in mainstream production or with standard jobs may be greater. Low-level, low-skilled labor provides for low productivity and, left without sufficient guidance, instruction or monitoring, it can even be detrimental to the organization. In such cases there is need for more centralism and strict hierarchy; stricter control over the use and dissemination of information is needed; reports are strictly formulated with tasks precisely defined. Workers are not given additional information and no opinions or subjective information are collected from them. Another reason why excessive information is not provided is that units often cannot process too much information. This could be due to either: 1) the large size of the organization or processing unit or 2) the complexity and type of the information. It is then the task of the executive or team of managers to process the information for the subordinates or units and the center turns into an information processing unit while workers conform to the commands of the center. Such concentration of information serves to economize on transaction costs as the center specializes in the processing, transmission and dissemination of information. Under the conditions of significant

⁹ Nye (2008, 68) writes that a company with a mature technology, stable growth, and a contented labor force will look for a different leadership style than a company facing turbulent markets, rapid technological change, and major outsourcing.

opportunism units and subordinates have incentives to hide information. Autocratic leadership obliges them to fully disclose that information.

The generation, processing and transmission of information become transaction cost reasons for the emergence of the multidivisional organizational form (Williamson, 1985, 279). Tactic, operational managers perform day to day operations and in this resemble transactional leaders, described earlier, charged with the success and survival of the individual unit, branch or subsidiary. Their information is limited, concentrated only on the particular unit or specific set of operations. Most of the information is concentrated in the strategic unit of the corporation; more precisely it is in the hands of the transformational leaders, strategic thinkers who set the vision and mission of the corporation based on their knowledge and predictions about the future of the industry. According to Williamson (1985) those visionaries are relieved of the tedious, day-to-day operations in order to set the strategy unbothered of the transaction costs of daily operations. Operational managers, for instance, are responsible for finding materials and components for the specific unit or subsidiary, monitor the work of employees within that division or supply other divisions with output, capital, knowhow, etc. In the linear organizational structure both tactic and strategic decisions are taken by top management which burdens it excessively with information, increasing thus the transaction costs of internal operation. Williamson (1985) sees the roots of the modern western corporation in the multidivisional form where the separation of strategic from operational management allows minimizing transaction costs and handling those costs most effectively.

Authoritarian management is appropriate when standard products are produced, product features are identical and there is little creativity in the production process. Production time is limited which further limits the time for reaction or decision-making. As a result there is no time to lead negotiations, discussions or debates; there is not even time to provide detailed explanation to workers and they are given direct commands on specific processes rather than detailed instructions on the whole production or project. Thus with the authoritarian style, due to lack of time, workers have only fragmented knowledge of operations or the production process. When the costs of intrafirm organization are high due to costly and lengthy negotiations, discussions, deliberation, haggling or excessive opportunism, authoritarian management is a preferable way of directing the organization. With such quick tasks there is little time for thought or planning; the margin for error is also very limited thereby prohibiting managers to take the risk of delegating essential tasks to unknowledgeable workers. When external conditions are dangerous rigid rules and discipline lower the possibility for mistakes. Under extreme circumstances such as in times of a crisis, in the military or the police orders have to be acted upon without any hesitation or questioning. The Soviet economy in the conditions of war is a good example of such extreme circumstances where commands must be followed unconditionally and immediately.

The authoritarian leadership style is common when there is little competition in the sector, usually in monopoly-type organizations which concentrate market power and tend to experience stronger centralism and a more hierarchical structure. Centralized systems tolerate qualities and attitudes such as discipline, triviality, collectivism and loyalty. Decentralized systems at the same time operate based on liberty of decision making, creativity and individualism. Table 1 contrasts these characteristics of the two types of systems or organizations.

Centralism	Decentralized systems
discipline	liberty
triviality	creativity
thoughtlessness	thoughtfulness
loyalty	disobedience
sacrifice of personal interest	self-interest seeking
altruism	selfishness
collectivism	individualism
output maximization	profit maximization
censorship within the organization	freedom of speech and opinion
dictatorial leadership	democratic leadership
process oriented	outcome oriented
risk-averse employees	risk-loving employees

Table 1. Characteristic features of centralized versus diversified systems (organizations)

Source: The authors

Lack of discipline in an organization or a team may result from poor organization, lack of leadership, inability to set deadlines or coordinate the activities of team members. A strong and firm leader can take over the group, assign tasks to the members, establish solid deadlines for projects and monitor loose workers. Without order any system comprising multiple, interacting elements would disintegrate – command-and-control prevents anarchy and insures the survival and success of the system.

In the conditions of war or very stressful situations autocratic leadership allows members of the group to focus on performing specific, simple tasks relieved of the burden to make complex decisions. Thus in

military or war-like situations command-and-control allows some amount of specialization and division of tasks which members of the group become particularly skilled at.

The autocratic leader is viewed as dictatorial and bossy, but the managerial costs of internal organization and the risks and responsibility he bears are often ignored. His desire to exert ultimate control over the organization is seen as extreme selfishness or narcissism. The command-and-control manager is faced with excessive worker opportunism or often perceives worker behavior as opportunistic. He strictly controls work schedules (such as employee time in the workshop, plant or office), output (for instance, number of units produced, customers served or sales achieved), or costs (such as the number of phone calls made, amount of materials and components used or the number of trips made). Furthermore, opportunistic workers may be reluctant to share the accountability and risks borne by management. They could be risk-averse either because they prefer to perform at their minimum for a modest but certain payoff or because their goals contradict those of the organization, as the case often is with opportunistic members of a team. At the extremum the interests of such opportunistic members may be so divergent from those of the team, unit or organization that they directly sabotage the group. Sloane (2016) provides an interesting comparison between the features of the authoritarian and the innovative leader which gives a good description of autocracy (Table 2). Sloane (2016) emphasizes that a leader could demonstrate different types of qualities depending on the circumstances he operates in. We expand these features to opportunistic organizations which reveal some further features of authoritarian leaders, as shown by Table 3. While an individual may embody one of the two types of leadership, he or she may demonstrate a combination of qualities concurrently.

The command-and-control leader...	The innovative leader...
leads from the front.	leads from the side.
directs.	inspires.
checks and controls.	trusts and delegates.
improves effectiveness and efficiency.	finds new approaches.
thinks he knows best (and often does).	harnesses the abilities of others.
has a strong sense of direction and purpose.	has a clear vision and communicates it.
prioritizes operational over strategic issues.	prioritizes strategic over operational issues.
gives directions and orders.	asks questions and solicits suggestions.
treats staff as subordinates.	treats staff as colleagues.
is decisive, often without prior consultation.	ponders and solicits input before making

	decisions.
builds a team who can execute policy and implement plans.	builds a team who can create and innovate.
instructs.	empowers.
hires based on experience, track record and qualifications.	hires based on attitude, creativity and latent capabilities.
discourages dissent.	encourages constructive dissent.
cares about results above all.	cares about ideas, peoples and the vision.
promotes himself as the leader and figurehead.	shares exposure and prestige with the team.
encourages action, activity and work.	encourages ideas, innovation and fun.
rewards performance.	rewards entrepreneurial action.
is numbers-oriented and analytical.	is ideas-oriented, analytical and intuitive.
sees technology as a means to do things better, faster and cheaper.	sees technology as a means to do things entirely differently.
minimizes risk.	takes calculated risks.
abhors failure.	is comfortable with failure.

Table 2. Characteristic features of authoritarian versus innovative leadership

Source: Sloane (2016)

The command-and-control leader...	The innovative leader...
ishighly intelligent but cautious.	is impulsive and strongly entrepreneurial.
seeks information all the time.	is uninformed much of the time.
takes decisions quickly.	takes decisions slowly.
optimizesand aims quantitative results.	cares about qualitative results and corporate spirit rather than pure numbers.
works with precision and is meticulous with details.	does not pay much attention to detail.
doubts people in the organization.	trusts people in the organization.
works with uneducated employees.	works with sophisticated staff.
works with a chaotic team.	has a disciplined team.

faces strong intrafirm opportunism.	receives cooperation and understanding.
has engineering or technical skills.	often lacks technical skills.
is technocratic.	is creative.
is the quantitative type and has good computational skills.	often lacks quantitative skills, applies a qualitative approach
is monochronic.	is polychronic.
is introvert.	is extrovert.
is a bad communicator.	is a good communicator.
listens carefully.	speaks vehemently.

Table 3. Authoritarian versus innovative (democratic) leadership

Source:The authors

It is believed that autocratic leadership prevents creative solutions and limits flexibility in the organization. Autocracy in management is also criticized for stifling innovation and blocking valuable ideas from employees. At the same time little contribution can be expected from low-productive, uneducated workers who lack sufficient preparation or operate in industries which represent traditionally low-value added sectors. The authoritarian leader is often the most knowledgeable member of the group or has access to information that other members do not have. An illustration is the Soviet-type firm where all information is concentrated in the manager or director of the socialist enterprise. This information is brought down to him from the central committee, ministry or trust through the standard process of disseminating planning information in the socialist system¹⁰. In this peculiar process of socialist transmission of information trusts, ministries or associations serve as a strategic center which sets the strategic goals of the enterprise while the individual socialist manager is charged with the task of day-to-day operations as well as transforming the strategic decisions of the trusts into operational¹¹. Ordinary workers and employees are uninformed of the decisions of the strategic center and have to act upon the commands of the informed manager. This allows relocation of tasks and minimization of transaction costs.

5. Authoritarian management in non-market economies

¹⁰ Arrow (1985) criticizes the socialist state in that the individual productive units have incentives not to reveal information about the possibilities of production to the central planning unit because it will be easier to operate with less taxing requirements. According to him the problem for the central planning unit (the principal) is how to tap the agent's information where a similar problem occurs in decentralization within a firm.

¹¹ See Sacks (1988) on information transfer and transaction costs in socialist systems.

Former socialist countries have the history of being traditionally non-market economies. They face significant transaction costs of market exchange in their attempt to establish market economies. Societies where opportunistic members dominate are more prone to market failure and economic underdevelopment. Former Soviet-type economies faced with contractual opportunism, high market uncertainty and costly information are subject to sizable transaction costs which determine a greater degree of centralism than in non-opportunistic, low-transaction cost, market economies¹². According to Sacks (1988, 867) behavioral and transactional problems such as bounded rationality and opportunism existed in non-market economies even at the time of socialism and justified putting transactions inside the firm similar to western companies.¹³ Bounded rationality makes the planning task more costly while opportunism has high social costs since more resources are devoted to the planning process or compliance with it, higher levels of inventories are maintained, and there are extraordinary duplication and fragmentation of productive capacity. With state-run monopolies enterprise managers do not have the freedom to choose among many alternative suppliers. Opportunistic behavior and the high costs of interfirm operation within the socialist economy determine a stronger degree of centralism and a larger size of the very firm. Firms do not disclose information fully in order to get favorable input allocations and output targets¹⁴.

These transactional and behavioral failures exist not only outside the firm in its interactions with its external environment (monopoly suppliers, distributors, the central planning committee, the pricing committee, the industrial trust or association), but also inside it. Because the socialist enterprise itself is a monopoly, a branch of the state firm which serves a particular sector or sphere of the economy, it comprises a large number of people the manager is in charge of. Authoritarian management becomes a suitable way to control large numbers of low skilled workers. Since all or most crucial information is concentrated in the hands of the central committee, Politbureau, the apparatchiks, the economic nomenclatura or the manager himself workers are uniformed and unknowledgeable. The socialist economy famously known for producing standard products where general-purpose equipment is used with almost no use of specialized machinery and without sophisticated, highly technological or complex final products utilizes low-skilled, unsophisticated labor. The socialist manager finds himself charged with a difficult task – to manage and monitor a large unqualified labor force where decisions need to be made

¹² In East European economies despite the relative freedom from the state few markets clear, market information is strongly asymmetric, there are more instances of market power, economic agents have not trusted each other or in markets altogether, markets do not seem to evolve with the passage of time and self-interest seeking is its strongest form is the prevalent pattern of economic behavior.

¹³ Sacks (1988, 866) writes: “While the environment surrounding the firm is different in market and non-market economies, many of the reasons for bringing transactions inside the firm are the same.”

¹⁴ According to Sacks (1988, 868) in communication with central planners socialist managers overstate input coefficients, capital needs and product redesign efforts.

quickly without consulting these large groups. Since there is no market allocation and marketing tools to study demand, production targets set by the plan in an administrative, bureaucratic manner must be fulfilled in a shortest period of time. The protracted haggling of democratic leadership which takes longer to reach a decision is inefficient in accomplishing the goals of the state-owned firm. Because the Soviet-type economy is in a constant state of presumed external threat from the west, uncertainty or crisis, command-and-control ensures the optimal way of organizing activities within the state-owned firm. Lack of work discipline, disorganization, lack of firm leadership or proper coordination in such stressful conditions would bring the system to a collapse.

Central to the problem of intrafirm organization is worker opportunism exceeding levels perceived as normal in western corporations. Because of the simplicity of labor and production processes socialist workers are often likely to shirk, goof off or relax at the workplace. Since team effort is rewarded more than individual effort in collectivist societies and workers are paid equally, free riding is common, with the individual input being hard to measure or monitor. Lacking tradition in the operation of the market or historical experience in industrial development workers are unaccustomed to industrial production, production norms and yields. Excessive shirking on the job imposes the need for strict control so that production targets are met in a short period of time. Since the Soviet system emphasizes quantity indicators more than quality,¹⁵ workers massively shirk by sacrificing quality for quantity. Production targets are met at the minimum quantity and quality levels. Workers cheat on indicators or parameters which cannot be measured strictly. For instance, check-in and check-out time in the factory is strictly monitored with the help of a timer or check-in cards, therefore, workers are punctual with entry and exit. But since work breaks in the workshop are not timed strictly workers have the tendency to take excessively long breaks.

The authoritarian management style becomes most prevalent in the centrally planned system allowing it to achieve its maximum output by preventing the high costs of worker opportunism. Here comes Taylor's scientific management in applying a bureaucratic top-down administration of economic directive, a command-and-control type of leadership aimed to meet production quotas, ultimately resorting to coercion and dictatorship in reducing the transaction costs of internal organization. In the 1920s and 1930s in pursuit of increased efficiency the Soviet Union adopted Taylor's scientific management which lay the

¹⁵ The system operates on the basis of success indicators such as the number of items produced, the number of labor hours used, the amount of raw materials, parts or components used. Five-year plans measure the quantity of final output or items produced. Minimum production targets are set by the plan known as quotas.

foundation of the five-year plan.¹⁶ Scientific management, a western model of firm organization, appealed to Soviet leaders not just because economic inputs could be measured precisely or optimized by design but because it used directives and commands to curb workers in the conditions of a non-market economy. In the German Democratic Republic workers were discussing how each task should be done in the enterprise and how long it should take following the principles of the Toyota production system.

While quality and production goals are not priority of the central plan, minimum standards are followed. The socialist manager embeds in this the principle of sufficing formulated by Simon (1947) not really seeking to maximize output or quality but rather following administrative decision making. Simon (1947) compares the economic man with the administrative man where the former “maximizes, selects the best alternative from among all those available to him,” while the latter satisfices by looking for an action that is satisfactory in the presence of limited knowledge. Under positive transaction costs the administrative man is boundedly rational – he simplifies the world by ignoring the interrelatedness of things, thought and action and makes decisions with relatively simple rules of thumb that minimize the transaction costs of information processing and his limited knowledge of the world.¹⁷ Since the socialist manager has to optimize but is constrained by his limited information about a complex environment, he takes on a satisficing behavior and adopts the administrative mode of decision making.

With administrative decision making in state-owned firms products may not be of highest quality but should meet minimum quality standards or otherwise managers would be punished. Production plans are exaggerated and production results are falsified but only to an extent – managers expect to be penalized if they distort information too much. Deliveries are late but not excessively late – managers of both supplying and production firms could be fired if output is not produced on time or not produced at all. The ruler as the highest authority can penalize managers for misconduct, disobedience or poor performance. Production targets cannot be missed dramatically because performance and loyalty are considered synonymous. Failure to perform in a satisfactory manner is disobedience, while meeting the production target or quantity is evidence of loyalty. The socialist manager therefore cannot deviate substantially from the plan. Commands are preferred to suggestions since the latter require bargaining and

¹⁶ Aleksei Gastev (1966, 1973) conducted Taylorism in the Soviet economy under the name “nauchnaia organizatsiia truda,” i.e., scientific organization of labor. It was greatly supported by Lenin and Trotsky. Sorensen (Sorensen and Williamson 1956), a long-term manager of the Ford Motor Company, was brought as a consultant to share American production knowhow. Stalin (1976, 115) claimed that “the combination of the Russian revolutionary sweep with American efficiency is the essence of Leninism.”

¹⁷ Simon (1947, xxix) writes: “Administrative man recognizes that the world he perceives is a drastic simplified model... He makes his choices using a simple picture of the situation that takes into account just a few of the factors that he regards as most relevant and crucial.”

bargaining incurs negotiation transaction costs. Commands may be and are often changed but changes later need less arguing. Issuing new commands or changing commands is less costly than negotiating.

Control is process-oriented, rather than outcome-oriented, and is based on detailed prescriptions of how, when and by what means to produce particular outputs. Process-oriented control saves on transaction costs when internal organization is used to substitute burdensome and risky market operations. Giving commands, directives and orders to subordinates increases efficiency within the centralized organization. Controlling economic activity means simply that the apparatchiks and economic bureaucrats are able to issue commands (“suggestions” at the very least) affecting process or product.

In a centralized system loyalty and obedience may be more important than competence, managerial talent or other expertise. Thus nomenklatura recommends or approves appointments for all managerial positions based on loyalty rather than creativity or technical skills although both might be sought. The most obedient, disciplined and best performing (meeting production targets and following commands, suggestions or guidelines closely) are appointed as managers. Often efficiency from competence and professional skills is sacrificed for the sake of loyalty. In effect, loyalty is efficiency in a centralized system since the system relies on commands, orders and directives. Loyalty is much more important in such a system than creativity, individuality, competence, knowhow, etc. The manager himself is a technocrat, a person of good engineering, technical or other skills, always aiming to find optimal solutions within the firm. Coercion is his main style in leading the organization paired with good knowledge of the production process. Under high transaction costs of social organization a centralized system based on dictatorial decision making, economic control and planning is, in effect, efficient.

Workers show little initiative and in fact expect and welcome directives and commands from the managers. Much of the time they prefer to bear no responsibility or risk and receive a lower wage for certain rather than share risk with management and receive a high premium. If left without precise directives and control or instructed to use creativity workers are unable to operate and the production process stops.

Greater opportunism, difficulty to exert control, difficult and costly measurement of output and monopolism determine stronger centralism in industry. Lower transaction costs and the presence of small-size producers in agriculture reflect a higher degree of competition and less centralism. The relaxation of command-and-control in industry is accomplished by limiting the number of obligatory plan indicators for enterprises, abolition of commands and their substitution with guiding principles, simplifying enterprise management, “orientating” and “auxiliary” indicators, “controlling figures,” etc. There are

disincentives to decentralized management in the state sector – nurturing centralized management in the state sector reduces transaction costs and is more efficient in the conditions of a state-run economy.

With traditionally opportunistic workers authoritarian management has become the norm in Eastern European economies. With few exceptions most managers apply the autocratic style since contemporary attitude to work has changed little from the time of socialism. In societies where there is stronger tendency for opportunism, there are higher transaction costs of organization associated with creativity, innovation, freedom at the workplace and power delegation. There is more centralism in industry since industrial sectors incur higher transaction costs and are also more prone to market failures such as monopoly power. Organizations tend to follow a strictly hierarchical form more than a diversified structure. Strongly centralized systems reduce to a greater extent intrafirm transaction costs while maximizing overall economic output and providing for efficiency at the aggregate level. In the presence of higher transaction costs centralized, nondemocratic systems work better by lowering those costs and increasing cumulative wealth rather than decentralized, market-type, democratic systems.

Conclusion:

We have tried to demonstrate that authoritarian management fits well in centralized organizations with more opportunistic workers or other factors increasing the transaction costs of internal operation. Bureaucratized institutions operating in stressful environments where work discipline is poor, there is lack of coordination or there is need for quick decision making have managers who tend to be more autocratic. Authoritarian leadership can significantly reduce intrafirm transaction costs in organizations and systems where the attitude to shirking is stronger such as traditionally non-market societies. The contemporary work mentality still provides for authoritarian management to be commonly used in transitional economies.

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